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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

REYNOLDS METALS COMPANY,
ASSOCIATED INDUSTRIES OF ARKANSAS,
RICELAND FOODS, INC., AND WEYERHAEUSER COMPANY,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

PETITIONERS' REPLY BRIEF

A. RAYMOND RANDOLPH
Counsel of Record
DANIEL I. PRYWES
PEPPER, HAMILTON & SCHEETZ
1777 F Street, N.W.
Washington, D.C. 20006
(202) 842-8100
KENNETH A. BARRY
Reynolds Metals Company
6601 W. Broad Street
Richmond, VA 23230
(804) 281-2189
Attorneys for Petitioners

PRESS OF RAM PRINTING, HYATTSVILLE, MD 20781 (301) 864-6662

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PETITIONERS' REPLY BRIEF

No one disputes the enormous practical and legal importance of the issues presented. For the parties, this case raises the immediate question whether FERC may "reallocate" the capacity of the $3 billion Grand Gulf nuclear plant among four electric utilities serving millions of customers in four states. For Arkansas ratepayers in particular, this case will determine whether FERC may drastically alter that State's economy, and override the authority of the Arkansas Public Service Commission ("Arkansas PSC"), by forcing Arkansas Power & Light Co. ("AP&L") to become a purchaser of unneeded capacity from that "catastrophically uneconomical" facility. (App. 7a.)

The legal issues presented are far-reaching. Whether FERC may divest the States of their traditional regulatory authority over the generation facilities and wholesale purchases of electric utilities that are part of an integrated system has enormous consequences. Such utilities account for more than half of the nation's generating capacity. (Petition of Reynolds Metals Co., *et al.* ["Ark. Ind. Pet."] at 12 n.10.)

Review by this Court is warranted. FERC has recognized from the outset that this case presents "extremely difficult and controversial cost allocation issues which have no easy answers" (App. 145a). The reasoning of the court of appeals cannot stand up to examination and respondents' attempt to support it does not succeed.

1. After we filed our petition, the Court decided to hear *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970, *jurisdiction postponed*, 56 U.S.L.W. 3242 (U.S. 1987). The question presented in *Mississippi Power & Light* is whether a State regulatory commission must increase an electric utility's retail rates to reflect the FERC-ordered "reallocation" of Grand Gulf capacity challenged in this case, even if the State commission has not

determined that the Grand Gulf costs were prudently incurred.[1]

We suggested that this case be heard in tandem with *Mississippi Power & Light*. FERC argues, however, that the cases present "entirely distinct" issues. FERC Br. at 22 n.21. To the contrary, both cases involve the proper delineation of federal and State jurisdiction over electric utilities; both cases involve disputes concerning the proper interpretation to be given to the Court's recent decision in *Nantahala Power & Light Co.* v. *Thornburg*, 106 S. Ct. 2349 (1986); and as even FERC concedes, the underlying validity of the FERC "reallocation" order challenged in this case is a "premise" of the dispute in *Mississippi Power & Light*. FERC Br. at 23 n.21. Indeed, whether FERC has statutory authority to "reallocate" the capacity of the Grand Gulf generation facility is, by any measure, far more significant than the subsidiary question, posed in *Mississippi Power & Light*, concerning the precise manner in which the States are to set retail rates in light of FERC's order.

2. Respondents ignore the States' substantial role in regulating the individual MSU operating companies' generation facilities and wholesale purchases.[2] Instead, they

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[1] The Eighth Circuit, addressing a related issue, recently held that the Missouri Public Service Commission is not required to increase AP&L's retail rates immediately to reflect FERC's "reallocation" of Grand Gulf capacity, but rather may do so in accordance with the normal suspension and investigation procedures used by that State commission. *Arkansas Power & Light Co* v. *Missouri Public Service Comm'n*, 829 F.2d 697 (8th Cir. 1987).

[2] The MSU Operating Committee did not have the authority to direct any MSU operating company to construct a generation facility unless such construction was authorized under the laws of the State where the facility was to be built. In Arkansas, for example, the Arkansas PSC is required to approve AP&L's construction of generation facilities and AP&L's transactions involving the purchase of generating capacity. (Ark. Ind. Pet. at 5 n.4, 27 n.31.)

emphasize the highly integrated nature of the MSU system and AP&L's claimed participation "in the system decision to build Grand Gulf 1." FERC Br. at 18. But that has nothing to do with FERC's jurisdiction under the Federal Power Act. The Act carefully delineates federal and State jurisdiction over specific facilities and transactions, with the States having the preeminent role.[3] (Ark. Ind. Pet. at 14.) Under the Act, the regulatory jurisdiction of a State over an electric utility's facilities and transactions is neither diminished nor expanded by the fact of the utility's integration or affiliation with utilities elsewhere.[4]

We have previously shown that the Act specifically withheld from FERC, and reserved to the States, regulatory authority over utilities' generation facilities and wholesale purchases.[5] No exception was provided for "integrated" utilities. Respondents not only ignore this fundamental proposition, but also totally disregard the Act's firm declaration that "Federal regulation [is] to

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[3] The Act was "'conceived entirely as a supplement to, and not as a substitute for, State regulation.'" *Connecticut Light & Power Co.* v. *Federal Power Commission*, 324 U.S. 515, 525 (1945).

[4] The Public Utility Holding Company Act similarly was not intended to diminish State authority over the utility subsidiaries of holding companies. (Ark. Ind. Pet. at 25.) Indeed, when the Securities and Exchange Commission determined that MSU met the statutory standards for holding companies, it found that the system "is not so large as to impair the effectiveness of regulation in any of the states in which the company operates." *In the Matter of Middle South Utilities, Inc.*, [1952-56 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,219, at 79,105 (1953).

[5] Section 201(b)(1) of the Act provides that FERC shall not have jurisdiction "over facilities used for the generation of electric energy" except as "specifically provided" elsewhere in the Act. 16 U.S.C. § 824(b)(1). Similarly, FERC's authority over wholesale transactions in Section 201(b)(1) extends only to "sales" and not to purchases. (Ark. Ind. Pet. at 14-15.)

extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a).[6]

FERC displays its indifference to the interests and regulatory powers of the States when it contends that FERC alone must be empowered to decide how the capacity of a generation facility serving utilities in several States is to be allocated, since the States could in no event coordinate that decision among themselves in an effective manner. This contention is incorrect. We explained in our petition (at 27-28) that the States, without infringing on FERC's jurisdiction over wholesale rates, can readily accomplish such an allocation either by the convening of joint federal and State boards, as Section 209 of the Act provides, 16 U.S.C. § 824h, or by requiring prior State approvals of a utility's wholesale purchases from out-of-state generating facilities. FERC acknowledges the argument (FERC Br. at 20) but offers no response. Although FERC may think it inefficient for the States to determine the degree to which their utilities purchase capacity of facilities such as Grand Gulf, Congress plainly did not share that view and rejected proposals to establish "regional" regulation of generation facilities. S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935). (*See* note 12, *infra*.)

3. When FERC does address the specific language of the Federal Power Act and the prior decisions of this Court, it adopts a strained interpretation characteristic of an agency that has overstepped its proper bounds.

Consider, for example, the stress FERC places on the language of Section 206(a) of the Act, which describes FERC's remedial power with respect to contracts "affecting" wholesale rates. 16 U.S.C. § 824e(a). Even FERC

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[6] One of the respondents would relegate the States to the role of intervenors in FERC proceedings, thus transforming their function from one of regulating to one of litigating. (SERI Br. at 22.)

acknowledges that this Section cannot be construed as authorizing FERC to alter *any* contract "affecting" a utility's costs, and hence its rates. Such an interpretation would allow FERC to supplant State regulation over matters, such as contracts for the construction of generation facilities, that are undoubtedly beyond FERC's regulatory domain. (FERC Br. at 12.) To cure the untenable consequences of its argument, FERC therefore invents two limitations on its Section 206(a) remedial powers. That Section, it argues, only permits FERC to alter contracts, like the Unit Power Sales Agreement ("UPSA"), that allegedly "affect" (i) intercompany transactions or (ii) the allocation of commonly-incurred costs between two utilities.[7] (FERC Br. at 13-14.)

FERC's argument, custom-tailored for this case, was not relied upon by the court below, has never been adopted by any other court, and has no support in the legislative history of the Act. As this Court has held, FERC may not invoke Section 206(a) to impose a remedy that "invade[s] a nonjurisdictional area"; FERC's remedial authority under Section 206(a) extends only to matters independently within its jurisdiction. *Federal Power Commission* v. *Conway Corp.*, 426 U.S. 271, 279

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[7] In fact, the UPSA did not determine the rates for wholesale power transactions between AP&L and the other MSU operating companies, but rather determined only the share of Grand Gulf's capacity and costs to be allocated to the three MSU operating companies other than AP&L. While FERC contends that the UPSA indirectly "affects" payments made between AP&L and other MSU operating companies under the System Agreement (FERC Br. at 13), it has not demonstrated that the indirect impact, if there is one, is other than *de minimis*. Moreover, FERC's theory would enable it to exercise plenary authority over every generation-related action taken by a utility that participates in a pooling arrangement, thus destroying the "generation facility" restriction that Congress built into Section 201(b)(1) of the Act. (*See* pp. 7-8, *infra*.)

(1976).[8] As we have explained, the "reallocation" order exceeded FERC's remedial authority because FERC has no statutory jurisdiction over generation facilities or wholesale purchases.[9] (*See* Ark. Ind. Pet. at 14-15.)

FERC is also wrong in suggesting that the Court's decision in *Nantahala* supports its interpretation of Section 206. (FERC Br. at 14.) The Court never mentioned Section 206 in *Nantahala* for the quite apparent reason that it was not reviewing the propriety of any FERC order or exercise of jurisdiction. Rather, the Court decided only that a State regulatory body, when setting retail rates, may not collaterally attack a FERC order governing the determination of wholesale rates.[10] (Ark.

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[8] *Conway* makes clear that Section 206(a) does not permit FERC to adjust contract terms that govern matters beyond its jurisdiction simply because such contract terms may "affect" wholesale rates. In *Conway*, the Court first held that Section 206(a) did not allow the Federal Power Commission (FERC's predecessor) to order a utility to increase its (nonjurisdictional) retail rates in order to remedy a discriminatory wholesale rate, 426 U.S. at 276-77, but then proceeded to hold that the Commission could consider such retail rates when exercising its power under Section 206(a) to adjust unreasonable wholesale rates. 426 U.S. at 280. In attempting to distinguish *Conway* (FERC Br. at 16 n.13), FERC completely ignores the first and crucial part of the Court's holding.

[9] The Court explained in *Connecticut Light & Power*, *supra*, that FERC's "jurisdiction does not depend on some independent application of the [Act's] regulatory provisions." 324 U.S. at 528. FERC therefore "get[s] the cart before the horse" (*id.*) in arguing here that a regulatory provision such as Section 206 can confer jurisdiction on FERC beyond that authorized in Section 201 of the Act.

[10] It is difficult to discern how the passage from *Nantahala* relied upon by FERC bears any relation to this case. (FERC Br. at 14.) In observing in *Nantahala* that a FERC allocation of low-cost power would "affect" a utility's costs and wholesale rates, 106 S. Ct. at 2359, the Court was simply addressing the question whether a State regulatory body was precluded under the filed-rate doctrine from utilizing a different allocation in setting retail rates.

Ind. Pet. at 19-21.) One of the respondents acknowledges that "[t]his proposition is not at issue in this case." SERI Br. at 23.

4. FERC and the other respondents contend that the "generation facility" restriction on FERC's jurisdiction, contained in Section 201(b)(1) of the Act, does not apply here because that restriction is qualified by the phrase "except as specifically provided." FERC claims that its supposed remedial authority under Section 206 to adjust contracts "affecting" rates is such a "specific" exception allowing FERC to regulate the Grand Gulf generation facility through its "reallocation" order. (FERC Br. at 15.)

This interpretation of the "generation facility" restriction conflicts with a common-sense reading of the Act's language. When Congress permitted FERC to exercise jurisdiction over "generation facilities" only where "specifically provided," it was referring to the several *specific* references elsewhere in the Act to generation facilities,[11] and did not intend to create an exception that engulfs the general rule. The legislative history of the Act further indicates that the extremely narrow jurisdiction given to FERC over "generation facilities" was not intended to allow FERC to regulate generation facilities on a regional basis, as it unabashedly seeks to do here, since Congress expressly rejected such regional regulation when enacting the "generation facility" restriction.[12] As against this,

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[11] We listed several such statutory provisions in our petition (Ark. Ind. Pet. at 22 n.23), and none of them have anything to do with this case.

[12] As noted in our petition (Ark. Ind. Pet. at 15), Congress rejected the Senate's original view that federal jurisdiction over generation facilities was needed "to secure the planned coordination of this industry on a regional scale." S. Rep. No. 621, 74th Cong., 1st Sess. 48 (1935).

respondents offer nothing.[13]

Although the court of appeals candidly acknowledged that FERC's "reallocation" order did result "to some extent" in the regulation of generation (App. 40a), FERC now suggests otherwise, arguing that the "generation facility" restriction only precludes FERC from regulating matters such as the "size, type, location, and operation" of generation facilities. FERC Br. at 15. FERC offers no support for this reading of the statute, which illogically would preclude FERC from regulating details of generation-facility planning while allowing it to take the far more intrusive step of "equalizing" the capacity costs of numerous generation facilities individually owned by four utilities. The drastic and direct impact of FERC's order on generation facilities is undeniable. FERC has foisted on AP&L unneeded and expensive capacity of the Grand Gulf generation facility, and at the same time has forced AP&L to share with other utilities the economical power generated by its own plants and certificated by the Arkansas PSC to meet Arkansas needs.[14]

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[13] FERC attempts to distinguish *Connecticut Light & Power, supra*, on the ground that it involved the "local distribution facility" restriction to FERC's jurisdiction rather than the "generation facility" restriction. The City of New Orleans finds it necessary in its brief (at 12) to stress the undisputed fact that Grand Gulf is not a "local distribution facility." The clear teaching of *Connecticut Light & Power*, however, is that the various restrictions on FERC jurisdiction in the Act that were intended to preserve State regulation—including the "generation facility" restriction—may not be nullified at FERC's whim because a nonjurisdictional matter may affect interstate commerce in some manner. As the Court explained, Congress "sometimes is moved to respect state rights and local institutions even when some degree of efficiency of a Federal plan is thereby sacrificed," and Congress did so in the Federal Power Act. 324 U.S. at 530. (*See* Ark. Ind. Pet. at 22-23).

[14] Although FERC labels as "fallacious" the contention that AP&L will be forced to share the benefits of its economical plants with the

5. FERC, like the court below (App. 44a n.75), does not dispute that it has no jurisdiction under the Federal Power Act to force purchases of wholesale power.[15] (Ark. Ind. Pet. at 15-16.) Instead, FERC takes refuge in the semantic claim that it has simply "allocated" costs among affiliated utilities, which it claims the authority to do because AP&L should not "be treated as if it were a stranger to the system." FERC Br. at 17.

FERC's position, if sustained, means that FERC may order any utility having a utility-affiliate to increase its total quantity of generating capacity and wholesale power—regardless of whether it needs such capacity or power—through a forced purchase from the affiliate. Nothing in the Act's language supports this startling proposition, which would totally emasculate the States' ability to regulate a utility's aggregate generation plant (and thus its total costs).

Similarly, FERC's proposition finds no support in this Court's decisions. As we have discussed, in *Nantahala* the Court assumed, without deciding, that "the particular *quantity* of power procured by a utility from a particular source" was a matter for State regulation. 106 S. Ct. at 2360 (emphasis in original).[16] The Court's assumption was

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other MSU operating companies (FERC Br. at 20 n.18), it does not dispute that this is the actual economic effect of the cost-equalization required by its "reallocation" order. Moreover, it must be kept in mind that FERC used Grand Gulf as the vehicle to "reallocate" the costs of *four* nuclear units owned by the individual MSU operating companies.

[15] FERC carefully skirts such a contention in asserting that it "frequently approves provisions for a seller's wholesale rates that, in effect, limit the options of a purchaser." FERC Br. at 19.

[16] Although FERC urges that *Nantahala* did not involve a question whether a utility procured an excessive quantity of wholesale power (FERC Br. at 19), it was precisely the absence of such a question that made it unnecessary for the Court to explore the full scope of State jurisdiction over the quantity of wholesale power purchased by utilities.

fully consistent with traditional State regulation of utilities' wholesale power purchases. (*See* Ark. Ind. Pet. at 13 n.12, 28 n.32.)

For the opposite view, FERC relies on *Pennsylvania Water & Power Co.* v. *FPC*, 343 U.S. 414 (1952). In that case, a utility was ordered to continue receiving and selling power pursuant to an existing Federal Power Commission rate-schedule in order to prevent the utility from frustrating a prior order of the Commission. (*See* Ark. Ind. Pet. at 26-27.) No issue was raised in *Pennsylvania Water & Power* concerning the scope of FERC's jurisdiction over wholesale purchases. The Court clearly did not address (let alone sanction) any FERC order, such as that challenged here, that would force one utility to increase its total supply of wholesale power and thereby prevent the State regulatory authority from exercising any effective control over the utility's wholesale power costs.

CONCLUSION

For the reasons stated above and in our Petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

A. RAYMOND RANDOLPH
Counsel of Record
DANIEL I. PRYWES
PEPPER, HAMILTON & SCHEETZ
1777 F Street, N.W.
Washington, D.C. 20006
(202) 842-8100

KENNETH A. BARRY
Reynolds Metals Company
6601 W. Broad Street
Richmond, VA 23230
(804) 281-2189
Attorneys for Petitioners

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